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## The Intuitive Investor Toolkit

NOW THAT EACH of the four principles has been introduced, it is time to combine them synergistically into powerful investment tools for your Intuitive Investor Toolkit. Each of the tools provides a context for understanding information at different points over the life of an investment: before buying, while holding, and after selling.

Your Cousin Vinny provides the context for understanding information prior to buying an investment. The Investment Thesis is a contract between yourself and an investment and is ideal for evaluating investments while you hold them. Thus, it connects you intimately with the investment information landscape. The Lessons Learned List is created after the sale of an investment and is designed so that you avoid repeating your mistakes. In my career I used each of these powerful tools to improve my investment success.

Because each tool is intimately associated with an exercise, keep your notebook nearby so that you can participate.

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### Context for Understanding Information Before Buying—Your Cousin Vinny

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Here's one of the greatest investment secrets. This simple exercise automatically puts you into the proper Investors' mindset before buying an investment. I am certain that you will be surprised at how much investment acumen you already possess as revealed by Your Cousin Vinny.

#### YOUR COUSIN VINNY

Imagine your cousin Vincent approaches you to invest in a coffee shop that is for sale in your hometown. Importantly, Vinny wants *you* to put up all of

the money to purchase the business. So you will be providing all of the cash equity. In return Vinny offers all of his knowledge and labor to run the coffee shop—this is the sweat equity.

What are the questions you **need** to ask Vinny before you are comfortable giving him your hard won dollars for the java shop? You grew up in a capitalist culture and have many years of experience as a consumer. This means you also have a wealth of knowledge to draw on when evaluating the quality of Vincent's coffee shop idea.

Because this is one of the most critical exercises of the entire book, you should really do the exercise. Twenty questions is the minimum number of questions allowed. Write your questions for Vinny down in your notebook right now.

Now compare your questions with my list of potentially relevant questions:

- ▶ Is Vinny trustworthy?
- ▶ Is Vinny hardworking?
- ▶ Does Vinny overwork?
- ▶ How does Vinny manage stress?
- ▶ How intelligent is Vinny?
- ▶ How wise is Vinny?
- ▶ Does Vinny have experience running a coffee shop?
- ▶ Should he organize as a corporation, limited liability company, limited partnership, partnership, or sole proprietorship?
- ▶ What are the benefits and costs of these legal forms of business ownership relative to owning a coffee shop?
- ▶ What will be the growth of coffee consumption going forward?
- ▶ What alternative products ( substitutes) are there for a cup of coffee?
- ▶ What will his menu look like?
- ▶ Will Vinny also sell food?
- ▶ How strong is his competition?
- ▶ How much competition does he have?
- ▶ How will he compete with all of the other coffee shops?
- ▶ Where is his competition located relative to the shop's location?
- ▶ Where is the java shop located?

- Is this location a good location?
- What is the quality of the shop itself? Is it in need of repair?
- What is the ambience of the coffee shop?
- What does he want the ambience to be like?
- How is his coffee, and other products, different from that of his competition?
- What will be his primary product? Is it going to be coffee?
- Where will he get his supplies and products from?
- What will it cost for him to get his supplies and products?
- What is the lead time before he can get products that he has ordered?
- What prices will he charge for his products?
- How did he derive the price for the products?
- How will he handle customer dissatisfaction?
- How will he handle an explosion of demand for his products?
- How will he handle a sudden decline in demand for his products?
- How will he handle any seasonality in his business?
- What kind of equipment does he need to purchase?
- What is the state of the equipment that is already in place?
- Does any of the equipment need repairing?
- How much depreciation is left on the equipment to take as a tax deduction?
- What will be the cost of the monthly utilities?
- How much is he going to pay his employees?
- Is this wage or salary competitive with other employers?
- What other benefits will he provide to his employees?
- Who will manage the operations of the business?
- Is this manager a good manager of customers, staff, and finances?
- Where will he find this person?
- How will he compensate this person?
- What if this essential employee leaves the shop?
- How will he market his coffee shop?
- Who will be responsible for the accounting?

- How much does it cost to do the accounting for the shop?
- To what health department or employer or other regulations does he have to adhere?
- What are the environmental risks of the java shop?
- What kind of local, state, and federal taxes will he have to pay?
- What will he do with profits?
- Does he want to grow the business?
- How will he pay for the growth?
- What proportion of debt will he use to purchase the business?
- What proportion of debt will he use to grow the business?
- Whom will he do his banking with?
- How will you get paid back for your investment?
- How much money does Vincent need to make the shop viable?

While this list of questions to ask of your cousin Vinny is very long, it is representative of the important issues confronting most businesses. Feel free to use it going forward in evaluating other investment opportunities.

How'd you do? Was there a lot of overlap between your list and mine? Are you surprised at how many of the pertinent issues you understood and listed? How many of the issues *you* identified did not show up on *my* list? Do not discount these issues as they came from you personally and therefore they are very important in your personal evaluation of an investment.

The "Your cousin Vinny" exercise is the exact mindset you need as you analyze a business for investment. Over the years I have done this exercise many times with family members, friends, stock brokers and audiences of investors, and no one has ever failed to identify the important issues of a prospective investment. Let me reiterate that point: audiences have never failed to identify the most pressing issues of a prospective investment. More importantly my audiences have also never, ever, come up with questions such as:

"What is the moving average price of coffee shops sold over the last 270 days?"

or

"Have the prices for coffee houses gone up dramatically over the last 3 weeks?"

or

"What are analysts/talking heads saying about coffee houses?"

You recognize these sorts of questions, don't you? These are the types of questions typically asked regarding potential stock market purchases. Interestingly, these sorts of questions don't come up when I ask: "What are the questions you need to ask Vinny before you are comfortable giving him your hard won dollars for the java shop?" Why?

The "stock-market-type-of-question" isn't asked because "Your Cousin Vinny" is the perfect context for evaluating a business for investment. The context is that of an iffy family member wanting to buy a local business. This immediately emphasizes that:

- ▶ You are investing in a business, not a piece of paper (a stock).
- ▶ There is a real chance of loss if you aren't cautious.
- ▶ You have a real choice whether you take on specific risks before investing.
- ▶ You have the innate knowledge necessary to analyze investments.

In other words, there is a profound sense of ownership when the question of investing is asked in this context.

Most importantly, once you take the magic word "stock" out of the question, and say "java shop" then everyone identifies the relevant issues. Investors invest in businesses, not in stocks, bonds, options, real estate, commodities, mutual funds, etc. A stock is just one way to own an interest in a business among many. So what is it about the word "stock" that causes people to go all loopy and to forget themselves, and to cast their intelligence and wisdom out the window?

I feel it has to do with the collective unconscious wherein resides the notion that stocks are equated with huge fortunes won, similar to the winnings from lotteries or in gambling. This is crazy. The only difference between buying a business interest in a private market transaction, like Vincent's java shop, and a public market transaction like the stock market, is liquidity. Liquidity is the ability to buy or sell your interest very quickly and at a fair price. This is the real and *only* magic of the stock market (or bond market or options market or commodities market or ...).

*What the stock market is doing is irrelevant  
in your evaluation of an investment.*

After you have become comfortable with the business issues identified in your analysis, then you ask yourself whether or not this is a good business. But, and this is a big but, good businesses do not necessarily make good investments.

*The only difference between a good business  
and a good investment is price.*

Before you make an investment in a business you must evaluate the price of the business. If the price of the business is reasonable, you may purchase an investment in the business. Unfortunately, a complete evaluation of an appropriate price to pay for a business is outside of the scope of this book. However, in the Appendix there is a list of good valuation texts.

Let's look at the four principles that the tool, "Your Cousin Vinny," makes use of:

The first principle of Infinity encourages you to see the many *interrelationships* between Vincent's coffee shop and everything else in the world. The Infinity Principle helps you place all of the facts of a situation on a topographical map. In the "Your Cousin Vinny" exercise, some of those facts are:

- ▶ Does Vinny have experience running a coffee shop?
- ▶ What alternative products (substitutes) are there for a cup of coffee?
- ▶ Where is his competition located relative to the shop's location?
- ▶ Where is the java shop located?
- ▶ What is the quality of the shop itself? Is it in need of repair?
- ▶ What will be the cost of the monthly utilities?

These are all facts that Vincent cannot change about the situation. They are givens and he must accept them if he is going to open a coffee shop with your investment monies.

Yet, even though Vincent's coffee shop is a part of everything as shown in the first Principle of Infinity, it is its own unique entity. So you need to figure out what *is* and *is not* pertinent to your understanding. Now you narrow infinite possibilities to distinctions, shown in the second Principle of Paradox. The "Your Cousin Vinny" tool asks you many questions to establish distinctness, such as:

- ▶ Is Vincent hardworking?
- ▶ How strong is his competition?
- ▶ Is this wage or salary competitive with other employers?

These questions are answerable relative to something else. They help you to narrow the scope of possibilities. The insistence of the Principle of Paradox that interrelated concepts can be opposite gives you good mental integrity for considering all of the relativistic sorts of issues that can affect a business. For example, it could be that Vincent is a hard worker, yet he overworks to such a degree that he is a candidate for burnout. So “hard-working” could be a good thing, or a bad thing. In other words, the second Principle of Paradox lets you know that every strength is also a potential weakness and that every weakness is also a potential strength. Opposite truths are not always absolutely equal in magnitude or importance. It could be Vincent’s hard-working nature has a higher probability of being beneficial than the negative probability that he might suffer from burnout. *Continuums* help you to understand these sorts of issues.

Principle III, Harmonizing, tells you that for the coffee shop to be successful Vincent must put in place many “coffee shop-like” structures if he hopes to have a viable business. For example:

- ▶ How does Vinny manage stress?
- ▶ Should he organize as a corporation, limited liability company, limited partnership, partnership, or sole proprietorship?
- ▶ How will he compete with all of the other coffee shops?
- ▶ What is the ambience of the coffee shop?

Vinny can choose to pattern his stress management on a technique he learned in a book or from a beloved therapist. Vinny can choose an ambience for the coffee shop that is evocative of his favorite coffee shop in Tuscany. This is the Principle of Harmonizing. This principle also says the easiest way to start a coffee shop is to use other coffee shops as the model.

Lastly, Vincent must choose to act. The coffee shop doesn’t open on its own. This is shown in Principle IV, Action. This principle is likely the easiest to understand, but there are several wrinkles. The fourth Principle of Action refers you back to the first Principle of Infinity because it says that effects follow causes. This is another way of saying that everything is inter-related. So if Vinny chooses to open the coffee shop (a cause) then all sorts of things will start happening (effects). Customers could come flooding in. The competition could lower prices. Trusted employees may quit. He could start making a lot of money. You must analyze Vincent’s business *from the beginning* with an eye toward the likely effects of the new business begin-

ning to operate. Principle IV: Action is all about choice. Vinny has all sorts of decisions to make about the coffee shop, such as:

- How will he compete with all of the other coffee shops?
- What does he want the ambience to be like?
- What will be his primary product? Is it going to be coffee?
- Where will he get his products from?

These are not the **facts** of the situation, these are choices, and hence, they are subject to the fourth Principle of Action. And “Your Cousin Vinny” makes use of all four principles.

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## Context for Understanding Information While Holding—The Investment Thesis

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Wouldn't it be nice to know the questions to ask of a business's management before investing? Wouldn't it be nice to have such an excellent understanding of a business that when you read the news you actually have an understanding of how that news might affect the business? Wouldn't it be nice to know the criteria that are legitimate reasons to sell your interest in a business? Wouldn't it be nice to make investment decisions more free from emotion? These are among the most difficult things for Investors to apprehend. But one tool helps with all of them: the Investment Thesis.

Earlier in the book I said the investment process is analogous to detective work. Well the investment thesis is your theory of “How the crime was committed.” It summarizes:

- The facts you believe are important to know about a prospective investment
- The facts you choose to trust when you purchase an investment
- Your opinion about the quality of a company's management, including their personalities
- Your feelings regarding the strengths and weaknesses of the company
- Your beliefs about the company's future prospects
- A list of the critical points that lead you to invest in the business

You create your Investment Thesis just after you are done with your analyses, but before you call the company and speak with an investor relations professional.

## THE INVESTMENT THESIS

The Investment Thesis is the contractual document you write that outlines the relationship between you and your investment. Just like all contracts The Investment Thesis provides the grounds for evaluating the relationship in an objective, legal-like fashion. Because you are the only witness to this agreement you must respect the Investment Thesis with sanctity. This means that if an investment violates the Investment Thesis that you have created then you will agree to sell it, rather than rationalizing a continued reason to own it. The Investment Thesis provides the perfect context for evaluating your ongoing relationship with an investment while you hold it.

Before you can write an investment thesis you need to have evaluated a prospective investment first. However, if you are not currently considering an investment, use an investment that you either made in the past or an investment you currently own.

Most importantly, before writing an investment thesis make sure that you are feeling grounded and not charged with emotions. In particular, you want to be free of elation, fear, or disgust about a prospective investment. The power of the Investment Thesis is that it is written at a time when:

- You are in an objective, non-attached mindset. This serves as the basis for evaluating potentially emotionally charged issues surrounding your investment. Examples include bad news about the business, a rapid decline in the value of shares of stock in the business's industry, and a violation of your Investment Thesis. Also, because of the objectivity at the beginning it serves as a check on "mission drift." This is where bad news is rationalized away by an investor. Referring back to the Investment Thesis ensures that no such rationalization can take place.
- The knowledge you have accumulated about the business is fresh in your mind. This ensures that you do not forget any information about the business you felt was pertinent at the time of purchase. As time goes on the Investment Thesis will represent the minimum amount of knowledge you have about the business as you will be continually adding information to your document.

Now write down in your notebook the name of the investment and the current date at the top of the document (see the Appendix for a sample investment thesis). Next record your investment time horizon. That is, how long do you expect to own this business? Alternatively, how long do you expect this business to contribute desirable returns to your portfolio?

Write down the strengths of the business—more is better than less at this point. For each strength you record, also include an estimate for how long you feel each strength might be in place. For example, if you feel that the business has a dominate product, write down how many years you feel this product will be dominate. Next, play “devil’s advocate” and imagine ways in which the strengths could be overcome by competition or pure chance.

Now write down the weaknesses of the business—more is better than less. For each weakness include an estimate for how long you believe each of the weaknesses might be in place. Play “devil’s advocate” and imagine ways that the weaknesses could be overcome by management efforts or pure chance.

The next part of the investment thesis is to record the things about the business that make you feel ignorant. Alternatively, what aspects of the business would you like to understand better? Also write down the things about the business that you feel anxious about.

Now write down a brief list of “The reasons I feel like buying this investment.” The list must be brief because restricting the list to brevity ensures that you will only list the most important issues.

In your notebook, make a short list of “The things that *would* cause me to sell the investment immediately.” Follow that list up with a short list of “the things that *might* cause me to sell the investment immediately.”

Next write down the price you feel is reasonable to pay for an interest in the business.

Now evaluate your investment thesis. How do you feel about this business? Are you comfortable? If not, what things make you feel uncomfortable? Do you need more information? If so, where will you go to get that information? How do you feel about the current market price of an interest in the business, especially relative to the price you feel is worth paying?

If you buy an interest in the business, record on your investment thesis the following:

- The price you paid for the investment next to your estimate of a price that is reasonable to pay.

- The date of your purchase next to your estimated investment time horizon.

Your investment thesis is a *living document* so you must update the thesis to reflect new and pertinent information that affects any aspect of the thesis that is already written down. Importantly: this does not give you the power to radically change the thesis as artificial support for your emotional connection to an investment!!

## INVESTMENT APPLICATIONS

### What Else Do I Need To Know?

If after creating your investment thesis you are still uncertain of a decision, it's a sure indication of two things: you don't have enough information to make a decision, or else your emotions are getting in the way of you being decisive. These are the very issues addressed in chapter three, "The Infinite Possibilities of the Information Landscape."

The investment thesis helps to highlight these issues for you so that you can move through them. Upon further personal reflection it could be the case that you have no legitimate reason for experiencing the emotions of feeling ignorant, in which case you make a decision: buy or not. But it could be that your emotional reactions about ignorance are entirely justified. In that case, you seek out more information until you feel you have just enough information to make a good decision (maximize the ignorance).

Because the investment thesis summarizes the information you know and do not know about a prospective investment, it serves to highlight appropriate questions for a company's management team. These are the types of questions such as: who is the firm's strongest competitor; what are the sales forecasts for each of the next five years; what key new products will be unveiled over the next several years; what mistakes has the business made and how did it learn from them. Frequently these questions cannot be answered easily by publicly available information. So a thorough investment thesis naturally suggests which questions should be directed to a firm's "investor relations" department, which nearly all publicly traded businesses employ. Look for the appropriate phone number or e-mail address on the company's website or on the bottom of the company's press releases.

### Overcoming "I Can't Decide"

The investment thesis is created and you are about to invest. You are confident you have the right amount of information to make a good choice.

However, you just can't decide. This is a sure sign you are experiencing either anxiety or fear. In this case you use the exercises outlined in chapter three to identify the true cause of your indecision. If you are experiencing anxiety then you muster your courage and choose to buy or not.

If upon reflection you are legitimately experiencing the intuitive emotion of fear then this is a strong sign that you should either not invest or that you should sell the investment if you already own it. Because you put these things in writing when you create your investment thesis, it helps you to make easier and better decisions.

### News Flow Evaluation

The Investment Thesis is the *basis* for your investment and thus it is what you compare news flow to in order to evaluate the effect of news on your investment. Say for example you are invested in an "exploration and production" company, that is, an oil company. Then say you read in *The Wall Street Journal* that the U.S. Government is going to provide massive tax breaks for businesses that invest in hybrid vehicles for their vehicle fleets. How do you evaluate this piece of news? You compare it to your investment thesis.

In your thesis you not only include the business strengths, but also the importance of time in your evaluation. If you feel the news violates any of the strengths, or reasons for buying that you listed on your thesis then you have very good *cause* for evaluating the investment's continued viability.

Just because a part of your thesis is violated does *not* automatically result in you selling the investment. However, if the news falls under the category of "things that would cause me to sell the investment immediately" then you *do sell immediately*. If the news doesn't violate the thesis, or if you feel that management can respond to the news event in a timely and intelligent fashion then your thesis is not violated. Therefore, you continue to hold the business. Or if you have not already bought an interest in the business then you buy.

### Less Emotional Decisions

Because the investment thesis is created at the beginning of your ownership in a business and I insisted that it should be created at a time when you felt free of emotions surrounding the business, it serves as the objective basis for evaluating situations as they unfold in the future. If you choose to honor the sanctity of your investment thesis and allow it to trump

any feelings you currently have about the investment then it acts as an unswerving check on your emotions.

### **Learning From Your Mistakes**

The thesis allows you a rapid way of evaluating your mistakes so that you learn from them, and (hopefully) never repeat them. During my career most of my mistakes were made because I either did not create a comprehensive thesis from the outset, or because I ignored the information in my thesis.

If your mistake is not having a comprehensive enough thesis then the lesson is obvious: next time you are more diligent! If you feel your thesis is comprehensive, but you missed something, then the next time you invest in a similar business then you include these new factors in your decision-making.

The mistake of ignoring your thesis is the most painful and the most difficult to overcome. This is because you are your own police officer and only you can choose to obey and enforce the law of your own thesis. This powerful tool is made impotent as soon as you elect to ignore it or revise it to suit your current emotional needs.

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## **Context for Understanding Information After Selling: The Lessons Learned List**

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While it may be comfortable to sit in a decision-free zone to ensure you never make a mistake, this is also likely to have the result of your never growing as an investor. If you invest, you will make mistakes. So rather than avoiding mistakes by never making decisions, as an investor your goal is to never *repeat* your mistakes. The tool for accomplishing this is the creation of “The Lessons Learned List.” The list is the embodiment of the age-old adage of: “Fool me once, shame on you. Fool me twice, shame on me.” The lessons learned list also provides the perfect context for evaluating an investment after you sell it (see the Appendix for a sample).

The lessons learned list should be created at two important times in the life-cycle of an investment:

1. At the end of each year even if you haven't sold an investment, and ...
2. Upon the sale of an investment

During the course of my career I made a list at the end of each and every year. But I would also update the list during the course of a year with any new lessons learned or important observations. So the lessons learned list is a living document that gathers together your accumulated investment wisdom. In fact, much of the content of *The Intuitive Investor* came from my collection of lessons learned.

For the list to be fully potent requires you to honestly and unabashedly confront your mistakes so that you do not repeat them. This sounds simple enough, but the process can be brutal. In fact, it's critically important to be 100% honest with yourself. After all, you are the only witness.

### EXERCISE: CREATING "THE LESSONS LEARNED LIST"

Upon either selling an investment or a calendar year having passed, make a list of the investment mistakes you made. Then carefully review the mistake so that you identify why and how you made it. Now use your creativity to imagine a remedy to the mistake. Write the lesson down on your Lessons Learned List.

Now list all of the lessons you learned, not just those arising from mistakes. Perhaps the lesson is just a simple observation or a mistake you avoided making because of a powerful insight.

The Lessons Learned List is very straightforward in concept, but having the fortitude to make your list each year and upon the sale of an investment is tough. If you make creating "Lessons Learned Lists" a habit, then each year your list gets shorter as you learn from your mistakes and avoid others.

### REVIEW

In this chapter I shared with you three powerful tools, each of which should occupy an important place in your Intuitive Investor Toolkit. Each tool addresses a different part of the investment life-cycle, before buying, while holding, and after selling.

Your Cousin Vinny provides the context for understanding information prior to buying an investment. Its secret is that it emphasizes that you are the owner of your capital investing in a business whose issues you likely understand well. The context of this tool ensures that you focus on the correct issues. Consequently, you avoid issues such as the daily gyrations of the stock market, or feelings of inadequacy regarding your ability to evaluate an investment.

The Investment Thesis is a contract between yourself and an investment. Thus, it connects you intimately with the investment information landscape. This contract provides the appropriate context for you to evaluate your investments while you hold them. This tool mainly helps to provide you with an objective framework for evaluating all of the news and emotional issues surrounding an investment.

The context of The Lessons Learned List is after the sale of an investment. The tool ensures that you learn from your mistakes by creating a living document that accumulates your investment wisdom. The primary goal is to avoid repeating a mistake in the future. Importantly, you may add any learned wisdom to your list.

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## Section Review

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In Part Two of *The Intuitive Investor*, “Activating Your Intuition for Wealth Manifestation,” I first shared with you the Seven Essential Investor Attitudes. The Attitudes are like subconscious mental programs that are always active. Accord with the Attitudes puts your mind more in alignment with the right brain. The Seven Attitudes were: Focus on Risks Before Opportunities; Comfort With Uncertainty; A Good Decision Is Most Often  $\geq$  The Perfect Decision; Forgive Yourself for Not Being Perfect; You Are Holding Investment Interviews; Why Does It Have To Be This One?; and Beware of False Prophets.

Next I revealed the Seven Essential Investor Behaviors. These are active mental programs that help to remove the majority of the distortions that prevent your right brain from functioning at its full capacity. The Seven Behaviors are: Choose Responsibility; Honesty; Balance Intelligence and Wisdom; Judge, Don't Prejudge; Courage; Conviction; and Assuming There Is a Why.

Principle III, Harmonizing, was introduced in part two. Accord with the third Principle is the crucial step that allows an investor to understand information as you harmonize with something to understand it. Next, Principle IV: *Action* was introduced. It emphasizes the power that lies in both responsibility and choice.